

Internal Revenue Service  
**memorandum**

CC:TL-N-466-92  
CORP:WHBaumer

date: DEC 20 1991

to: District Counsel, Los Angeles W:LA  
Attn: Charles O. Cobb

from: Assistant Chief Counsel (Field Service) CC:FS

---

subject: Request for Field Service Advice  
[REDACTED]

This is in response to your request, asking us to determine whether the taxpayer's [REDACTED] stock redemption is subject to the present I.R.C. § 305(b)(2) rules or whether the redemption is grandfathered as a result of the effective date provision to I.R.C. § 305(b)(2), contained in section 421(b) of the Tax Reform Act of 1969, at Treas. Reg. § 1.305-8. Under that provision, stock outstanding on January 10, 1969 (or April 22, 1969 in cases to which T.D. 6990 would not have applied) is grandfathered for purposes of I.R.C. § 305(b)(2) if, in pertinent part, a distribution of property and a distribution of stock was made on or before April 22, 1969, with respect to such stock. Furthermore, the property distribution must have caused the stock distribution to be disproportionate.<sup>1</sup>

On October 11, 1991, we requested coordination with the Corporate Division. We have now received the response from CC:CORP:4 of that Division (copy attached). That Branch concludes that the term "shareholder" for purposes of I.R.C. § 305(b)(2) includes holders of convertible securities, including convertible debentures and convertible preferred stock. Accordingly, payments of interest and dividends to holders of convertible securities are treated as distributions of property to shareholders for purposes of I.R.C. § 305(b)(2). Therefore, if either of [REDACTED]'s convertible securities (i.e. convertible debentures or convertible preferred stock) lacked a full adjustment feature for its conversion ratio, [REDACTED] would have made a disproportionate distribution of its common stock before April 22, 1969.

We are in agreement with CC:CORP:4 that because convertible debentures and convertible preferred stock are considered stock under Example (4) of Treas. Reg. § 1.305-3(e), the debentures and preferred stock should be considered "stock"

---

<sup>1</sup> This latter requirement is not contained in section 421(b) of the Tax Reform Act. However, the legislative history and several commentators believe the pre-January 10, 1969 distribution must be disproportionate. See H.R. No. 91-413 (Part 1), 91st Cong., 1st Sess. 115 (1969), 1969-3 C.B. 272 ("This transitional rule applies only if the corporate capital structure or corporate practices on January 10, 1969...provided for disproportionate distributions with respect to stock."); Tax Management Portfolio 94-5th, A-23 (E.2.(2)); and The Tax Adviser, June 1970, p. 366. We acknowledge that taxpayers may have an argument that because the language in section 421(b) is unambiguous, it is inappropriate to examine the legislative history of the section.

for purposes of section 421(b)(2)(D) of the Tax Reform Act of 1969. Accordingly, dividend and interest payments on [REDACTED]'s convertible preferred stock and convertible debentures are considered distributions of property with respect to [REDACTED] common stock for purposes of the transition rule.

We understand that Larry Smoller and Bonnie Cohen are in the process of determining from the taxpayer whether the convertible instruments contain anti-dilution features. If both of these instruments contain full anti-dilution features, it will be necessary to revisit certain other issues, such as whether any of the other distributions (such as the cash paid in lieu of fractional shares) qualify. It may also be necessary to determine whether the effective date provisions of the transition rule, here, are January 10, 1969, or April 22, 1969. This will depend on the applicability of T.D. 6990. We assume that the [REDACTED] common stock had a greater fair market value than the preferred stock on April 22, 1969, thereby satisfying 421(b)(2)(A)(iii) of the Tax Reform Act of 1969. We also assume that the exceptions provided in 421(b)(2)(C) do not apply. If either of these assumptions is incorrect, it may also be necessary to examine their consequences.

If you have any questions with respect to this memorandum, please contact William Baumer at FTS 566-3335.

DANIEL J. WILES  
Assistant Chief Counsel  
(Field Service)

By:

  
ALFRED C. BISHOP, JR.  
Chief, Corporate Branch  
Field Service Division

Attachment:  
As stated